

COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

_____))
Notice of Inquiry regarding the Provision)
of Default Service)
_____)

D.T.E. 02-40-B

**INITIAL COMMENTS OF WESTERN MASSACHUSETTS ELECTRIC
COMPANY ON THE DEPARTMENT OF TELECOMMUNICATIONS AND
ENERGY'S PROPOSAL TO CHANGE THE SOLICITATION PERIOD FOR
MEDIUM AND LARGE COMMERCIAL AND INDUSTRIAL DEFAULT
SERVICE CUSTOMERS**

Western Massachusetts Electric Company ("WMECO" or the "Company") appreciates the opportunity to comment on the Department of Telecommunications and Energy's ("Department") proposal to increase the frequency of default service solicitations conducted by electric distribution companies, such as WMECO. WMECO is fully supportive of the Department's policy of fostering the development of a competitive market for default service customers.

I. EXECUTIVE SUMMARY

WMECO recognizes the Department's strong interest in more frequent default service solicitations for larger customers, and, consistent with this interest, WMECO proposes that solicitations be held every three months. Although solicitations would be held quarterly, only monthly prices would be solicited (that is, there would be no three-month fixed rate). In addition, should the Department deem it warranted, the monthly prices obtained could be divulged only immediately prior to the applicable month rather than all at once prior to the beginning of the three-month period. A three-month solicitation period strikes an appropriate

balance given the interest in obtaining more current price information for customers and the difficulties in moving to a one-month solicitation period. At the technical session held by the Department on this matter on May 15, 2003, each of the state's electric distribution companies supported the three-month solicitation as an appropriate result. In addition, at the technical session, several other entities, including competitive suppliers, supported the three-month option.

II. BACKGROUND

On April 24, 2003, the Department issued an Order (D.T.E. 02-40-B) ("Order") addressing, in part, the solicitation period for medium and large commercial and industrial customers receiving default service (pp. 33-40). The Electric Utility Restructuring Act of 1997 (the "Act") established default service as an alternative to Standard Offer service and provided that it should be procured through competitive bidding, "shall not exceed the average monthly market price of electricity," and that all bids "shall include payment options with rates that remain uniform for periods of up to six months." G.L. c. 164, § 1B(d). The Act did not restrict the length of time any customer could be enrolled in default service.

In its Order, the Department stated that default service supply is procured through competitive solicitations for terms of six to twelve months and the "manner in which default service is priced for medium and large commercial and industrial ["C&I"] customers has a large effect on whether these customers will have the appropriate incentives to turn to the competitive market" (Order, p. 36). The Department further concluded that current procurement terms "provide default service customers with a level of price certainty that is more appropriate[ly]"

provided by the competitive market” (Order, p. 36). This, for default service, termed a last-resort service, is said to undermine retail competition (Order, p. 37).

The Department further analyzed and rejected subjecting C&I customers to hourly wholesale spot market prices given that customers may appropriately be “using default service as a short-term, last resort service” and given California’s experience with spot market fluctuations (Order, pp. 37-38). Instead the Department concluded that based on the information it had it was persuaded that a one-month procurement for C&I customers would (1) provide efficient price signals; (2) provide an appropriate level of price certainty; and (3) provide appropriate protection from spot market price volatility. Under the one-month approach, according to the Department, distribution companies would, for example, procure supply for May 2003 in April 2003 (Order, p. 39). In addition, the Department indicated that the increase in administrative costs incurred by the more frequent solicitations should be outweighed by the continued development of the competitive market (Order, p. 39). Nonetheless, in order to understand the issue more clearly, the Department scheduled the May 15 technical session and, then, comments from interested parties.

III. WMECO IS FULLY SUPPORTIVE OF THE DEPARTMENT’S COMPETITIVE MARKET GOAL.

As WMECO has stated many times previously, it completely supports the Department’s policy of fostering the development of a competitive market for both large and small customers. The Company has no interest in impeding the transition of customers from regulated energy service to retail competitive service. Indeed, the opposite is true. Given the Department’s determination that short term, more

contemporaneous prices will provide the appropriate incentive for larger customers¹ to turn to the competitive market, the only question that remains is how much to shorten the current six-month solicitation period.²

IV. A THREE-MONTH SOLICITATION IS PREFERABLE TO A ONE-MONTH SOLICITATION BECAUSE IT WILL SERVE TO ACCOMPLISH THE RESULTS DESIRED BY THE DEPARTMENT WHILE AVOIDING PROBLEMS NOW AND INTO THE FUTURE.

The Department is properly investigating the frequency at which default service is to be procured. WMECO recognizes that the current six-month period may be too long given the Department's objectives. However, when comparing a three-month procurement process with a one-month frequency, WMECO believes that a three-month cycle is far superior. It is not simply WMECO and the other distribution companies that see the benefit in a three-month process. At the Department's technical session, a number of other parties fully or partially endorsed a three-month procurement. Tr. p. 152 (Power Options); Tr. p. 169-170 (Constellation Power Source) (longer solicitation period for smaller electric distribution companies); Tr., p. 176 (Coral Power); Tr., p. 186 (Associated Industries of Massachusetts).

¹ The Department indicated that the new policy would be applicable to 'medium and large' C&I customers. For ease of reference, WMECO refers to 'larger customers' as the group to which the shorter procurement period would be applicable. WMECO notes that it is not clear exactly what the cut-off point would be or whether the cut-off point would be the same for each electric distribution company. At present, it appears that different electric distribution companies group customers differently. WMECO recognizes the position of the Associated Industries of Massachusetts which respect to exposing relatively small customers to monthly solicitations. See, Associated Industries of Massachusetts Comments, Tr., pp. 183 ("...the cutoffs are different for different utility companies....[Smaller C&I] customers that don't have choice in the market should not be subjected to monthly pricing....").

² WMECO is cognizant that some entities assert that a longer, not shorter, default service procurement period best facilitates a competitive market. See, e.g., Tr. p. 144. In light of the Department's order, however, that topic is beyond the scope of these comments.

The following are a number of reasons supporting a three-month default service solicitation requirement.

A. ISO-NE Timing Requirements and the Logistics of Finalizing a Contract Make ‘Just-In-Time’ Procurement Difficult, if Not Impossible.

The one-month procurement proposal the Department set out in D.T.E. 02-40-B indicated that an electric distribution company would procure power in month 1 for month 2 (“companies would procure supply in May 2003 during April 2003” (Order, p. 39)).³ While WMECO agrees that a price procured on April 30 for usage on May 1 would give a ‘fresh’ price to customers, current ISO-New England, Inc. (“ISO”) procurement requirements make this untenable.

Currently, when procuring power supply, ISO requires that it be provided with the identity of the supplier in a bilateral contract for capacity responsibility purposes approximately 25 days prior to a contract’s effective date in order to assign Installed Capacity (“ICAP”) obligations under the contract. Tr. p. 127. At the technical session, Massachusetts Electric Company indicated that the new supplier would have to be finalized one month ahead of time, or April 1 in our example, for ISO settlement purposes (Tr. p. 193). Whether the precise time requirement (or best practices requirement) is 25 days or 30 days, the point is the same: it is not possible to procure default service just prior to providing that default service. Even if the solicitation process were to end the day default service bids are received, the bidding period would have to conclude by the end of March or early April to provide the supplier information to the ISO for May default service.

³ In making this recommendation, the Department undoubtedly recognized that it would need to alter its own rules for prior notice to customers of changes in default service prices. Accordingly, WMECO does not here address the Department’s current rules requiring 30 days notice to customers.

Moreover, it is unrealistic to assume that a contract will be effective and submitted to ISO the day bids are received. WMECO's experience is that once bids are submitted there follows a brief period necessary to finalize the contract. This period, for WMECO, is typically no shorter than one week.⁴ Finally, WMECO assumes the Department will continue to require some period to review the solicitation process and the signed contracts. Currently, the Department requires five business days for this review.

Adding the ISO reporting factor to: (a) post-bid contract finalization; (b) filing with the Department; and (c) Department review, it is apparent that the procurement has to be 'locked up' by mid-March to supply default service in May. If the process has to be finished by mid-March, the bidding period likely must begin sometime in February (preferably mid-February). Massachusetts Electric Company stated that its schedule works precisely the same way. Tr., p. 192.

Accordingly, given these factors, it is not possible to solicit default service in April for May service. Rather, it would be necessary to begin a solicitation process for May default service with the issuance of a Request for Proposals ("RFP") in February. Then, before May service begins, solicitations would have to be initiated for both June and July. WMECO believes this stacking up of solicitations required by a one-month solicitation will lead to confusion and is not a sensible way to proceed. A three-month solicitation is far preferable because the entire default

⁴ WMECO's process also includes the Department's consideration of the report by an independent third-party on the impartiality of the procurement process. This report has been required by the Department in order to review WMECO's default service procurement. The independent consultant's report is generally compiled and submitted about one week after contracts are signed.

service solicitation cycle is currently slightly less than three months;⁵ one solicitation could come to conclusion before another begins.

B. Limiting a Solicitation Period to One Month Comes with Risk.

Inherent in a recommendation that default service be procured on a monthly basis is the assumption that the total procurement cycle will be completed in one month or less. Currently, WMECO's solicitation cycle is substantially longer than one month. The steps WMECO takes for each solicitation are as follows: (1) pre-issuance review of the language in the RFP and proposed contract; (2) issuance of the RFP and proposed contract, with the requirement that bidders submit any nonconforming contract terms prior to the end of the bidding period; (3) review of the nonconforming items; (4) negotiation of any proposed contract changes with the bidders; (5) receipt of final pricing information and evaluation of the winning bidder(s); (6) finalization of the contract(s) with the winning bidder or bidders; and (7) contract submittal to the Department for approval. While the Department sees just the end point in this process, it is critical to the success of the solicitation that the preceding items are performed and performed correctly. It is important that the RFP and proposed contract be reviewed in advance of issuance because particular language is needed, to protect, as best as is possible, the companies and their customers from rapidly changing conditions (and costs) in the wholesale market. Likewise, it is important to give parties an adequate time to bid. WMECO believes four weeks is an optimal amount of time to allow suppliers to place the solicitation on their calendars and prepare a bid. Massachusetts Electric Company stated that it always allows one month for bids. Tr., p. 193.

⁵ See, also, Section B, below.

The fact that WMECO's procurement process is now longer than one month does not mean that it cannot be shortened; it can be. To take one example, the bidding period can be shortened to fit whatever period the Department requires. However, with this shortened period comes the risk that there will be a lessened market response to the solicitation and/or higher prices than what otherwise could be obtained.⁶ For a company such as WMECO, with a relatively small default service load, this risk is particularly acute. The Department should factor in the risk of higher default service prices to customers, both to those larger C&I customers who have competitive alternatives and those smaller C&I customers who perhaps do not have adequate alternatives.

In WMECO's view, the present solicitations have been successful in obtaining reasonable prices for customers and have given all suppliers a full and fair opportunity to compete. The Company believes that given this success it makes most sense to allow solicitations to proceed along present timelines. A three-month solicitation accommodates the solicitation cycle; a one-month procurement period does not.

C. A Monthly Solicitation Period Makes Compliance with RPS Standards More Difficult.

One of the requirements placed upon electric distribution companies in their procurement of standard offer and default service is the requirement to procure a minimum percentage of sales to end-use customers from new renewable energy generating sources. See, Renewable Portfolio Standard requirements (225 CMR 14

⁶ The monthly period also means that there is no latitude for mid-course procurement corrections. WMECO has in the past interrupted its solicitation process to study events unfolding at the Federal Energy Regulatory Commission and in the markets to fine tune its RFP and contract language. There would be no opportunity to take these steps, which inure solely to customers' benefit, in a one-month solicitation.

et seq.) WMECO (and other electric distribution companies), in turn, requires default service suppliers to meet the RPS requirements for the Company's default service load and to provide whatever documentation and assistance is necessary in any inquiry by the Division of Energy Resources and the Department. However, record tracking for compliance pertaining to the certificates issued under the applicable regulations is conducted approximately four to six months in arrears. Such a time frame is not ideally suited to a six-month solicitation period because it would be preferable to check on compliance prior to the end of a supplier contract. A three-month solicitation period works less well. However, a monthly solicitation period presents significant additional difficulties. With a one-month contract, when a RPS compliance inquiry is initiated, a default service contract may have terminated months earlier and the supplier may no longer have a presence in Massachusetts. A separate, additional factor is that renewable energy entities have argued for a much longer contracting period (for example, ten years) in order to provide an adequate incentive to develop renewable energy. Reducing the contracting period to as little as one month may have a negative effect on renewable development, and change the market for renewable certificates.

D. For Smaller Electric Distribution Companies a One Month Solicitation Period Raises the Specter of Fewer Bids and Higher Prices.

For the smaller Massachusetts companies a monthly solicitation raises the possibility of a significantly diminished supplier interest. The medium and large C&I default service load for WMECO is quite small (for Fitchburg Gas and Electric Light Company it is much smaller still). Currently, when WMECO issues a default service solicitation, it is for default service load for four separate categories of customers (residential, small C&I, larger C&I and streetlight) for six months.

A monthly solicitation for medium and large C&I likely means that less than half of the total default service amount will go out to bid for one-sixth the time period. Accordingly, less than one-twelfth the kilowatthours will be solicited. A solicitation of this size raises the significant possibility that if suppliers bid,⁷ they will do so only at premium prices.⁸ Another option is that suppliers determine that there is simply not enough money to be made in a small solicitation to devote the time and administrative resources required to bid.

WMECO does not know how likely the 'no-bid' scenario is, but with 56 default solicitations a year (14 for each electric distribution company) it is possible that any one small solicitation might not attract supplier interest. WMECO urges the Department to take all prudent steps to avoid any possibility of this result, a result that could ultimately lead to confusion and very high costs to WMECO's customers. Because a three-month default service solicitation is more likely to attract bids than a one-month solicitation, WMECO believes this is another persuasive reason for a three-month solicitation.

E. Monthly Default Service Solicitations Could Lead to Increased Gaming of Solicitations by Suppliers.

At present, default service solicitations are spread out, with load procured by different electric companies in different months. Monthly solicitations, clearly, produce the opposite result – large blocks of load would be solicited at the same time. In WMECO's opinion, the current staggered solicitation schedule is preferable to large individual, simultaneous solicitations because simultaneous solicitations

⁷ At this time, WMECO is unclear as to how many separate customer categories would be bid in a monthly solicitation. If more than one category is solicited, the possibility exists that suppliers will bid on one category but not another.

⁸ Reducing the size of the smaller customer default service solicitations may also lead to a somewhat lesser interest in that solicitation.

could lead to supplier gaming (e.g., choosing to bid only in certain solicitations at certain times). WMECO is certainly not asserting that suppliers would do anything improper, but suppliers, as competitive entities, want foremost to maximize their profits (*i.e.*, sell at high prices), and the Department should carefully review protections for customers with a simultaneous solicitation process.

This issue is increasingly important as the Department looks ahead to the end of the transition period on March 1, 2005. As of March 2005, absent some legislative change, all regulated customers will be on default service. The total default service load, then, could be very large. At present, Massachusetts accounts for approximately 50 percent of the New England load and a large percentage of this load may be on default service on March 1, 2005.. Three-month solicitations mean that substantial segments of load can be bid out in different months (*i.e.*, National Grid can solicit in month 1, NStar in month 2 and WMECO/Fitchburg Gas and Electric Light Company in month 3).⁹ WMECO believes that this schedule is more likely to lead to successful solicitations than one in which all the companies are procuring service simultaneously.

F. The Monthly Solicitation Model Would Require New Data Delivery Systems and Impose Significant New Costs on Customers.

A change to a monthly default service solicitation will require that electric distribution companies provide data to suppliers frequently, on an expeditious schedule. The types of information that will be sought by suppliers were mentioned at the technical session. These included hourly historical loads, numbers of

⁹ In addition to the Massachusetts electric distribution companies procuring service there will be months in which other New England utilities are procuring regulated service. A three-month cycle also avoids all in-state and out-of-state service being procured at the same time.

customers coming back to default service, customers leaving for competitive service, and the load profiles of those coming and going. While the present system is sufficient to provide information to suppliers for a six-month or three-month solicitation period, significant additional administrative costs will be necessitated in order to provide the information on the much more frequent monthly schedule. Massachusetts Electric Company has estimated the cost of providing the information, including the information technology upgrades, at \$100,000. Tr., p. 196. It is reasonable to assume that costs at the other electric distribution companies would be similar. It is not clear how long it would take for WMECO or the other electric distribution companies to install and test the new systems needed.

Along with the administrative expense of data systems with a monthly solicitation, there will be significant increases in administrative expense associated with very frequent procurements.¹⁰ It is likely that WMECO will need to add staff dedicated to this one function. The cost of such staff has not been estimated as of yet, but it will be significant compared to existing administrative costs.

Both of these expenses are administrative and the Department has indicated in its Order that administrative costs will be borne by customers. In the Company's opinion, the imposition of these costs is unnecessary and yet another reason for looking to the three-month solicitation as the preferred alternative to one-month. Moreover, the costs that customers would bear will be related to increasing the electric distribution companies' workload with respect to generation and supply, an objective WMECO views as generally inconsistent with Act's and the Department's

¹⁰ WMECO also has an administrative expense that the other electric distribution companies do not have – the expense of an independent third party consultant's evaluation of each default service solicitation. This expense is very likely to cost substantially more on an annual basis than the \$100,000 one-time information technology expense.

directions that electric distribution companies reduce their participation in the generation function.

G. A One Month Solicitation Is Not Consistent with the Department's Measured Approach and Is Unwarranted.

Over a period of years, the Department has successfully established a solid framework under which default service is procured and the competitive market has taken hold. The Department has not made abrupt mid-course changes but instead has analyzed what works properly and what does not, and then has moved at a measured pace to make needed changes. This is important because in making changes the Department does not want to fix one problem only to find that the fix has caused another part of the system to break.

This approach is consistent with the changes the Department made in the Order with respect to bad debt and administrative expenses. The Department, after considerable thought, determined that bad debt and administrative expenses should be better reflected in default service costs. The Department's policy of measured, steady change, however, is not reflective of a monthly default service solicitation. A change from eight solicitations per year to 56 solicitations per year is abrupt and raises the very real specter that implementation problems will arise that are far more deleterious to the Department's goal than any current systemic difficulties.

In its Order, the Department has already made several significant changes to default service. It is possible that the bad debt and administrative costs will add 2 to 3 mills per kilowatt-hour to default service rates (Order, p. 14). A combination of the additional bad debt and administrative costs and a somewhat more frequent default service solicitation may well lead to the results the Department is seeking,

without a seven-fold increase in the number of default service solicitations and all the uncertainty they will bring.

V. CONCLUSION

The goal of fostering the competitive market for medium and large C&I customers is important and the changes the Department has ordered with respect to bad debt and administrative expenses, along with a three-month solicitation period, may achieve the desired goal. A three-month solicitation period also avoids a number of problems that may harm the default service system more than it helps. Further, a three-month procurement approach taken now does not preclude the Department from taking steps in the future to increase the frequency of solicitations should such a step become necessary.